Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Special Access Rates for Price Cap	)	WC Docket No. 05-25
Local Exchange Carriers	)	
	)	

COMMENTS OF

THE UNITED STATES TELECOM ASSOCIATION

ON THE

NOTICE OF PROPOSED RULEMAKING

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SUMMARY OF COMMENTS

The Commission has followed a policy of encouraging competition and reducing regulatory management of special access services for approximately twenty years. This policy has led to vibrantly competitive markets in which customers have many choices of providers and services offerings at steadily declining prices. Additionally, the Commission's pricing flexibility rules have enabled customers to secure more individualized contracts that meet their unique communications needs. Entry and exit have occurred and continue to occur freely, and technological innovations quickly reach the market through the competitive process. By any measure, the Commission's special access policy has been successful. The Commission should build on this success by further relaxing regulation of special access services, thereby making way for positive market-driven outcomes. The Commission should reject calls by those who would have the Commission turn back the clock to re-regulate this mature, competitive market.

The Commission asks many questions in the Notice of Proposed Rulemaking (NPRM) about the next phase in its special access policy and rules. USTA submits that the Commission has the opportunity to build on its special access success by extending pricing flexibility so that markets will increasingly be driven by competition and commercial agreements rather than regulatory mandates. In particular, the Commission should allow commercially-negotiated arrangements throughout the country as these must be seen as benefiting both parties and not reflecting the exercise of market power.

There are three fundamental principles for the Commission to follow in its oversight of special access markets: (1) the Commission should encourage investment in special access networks; (2) competition in customer-driven markets produces outcomes superior to regulatory prescriptions, and market-based competition is better able than regulation to respond efficiently

to the rapid technological change that is occurring throughout the telecommunications industry; and (3) regulation, to the extent it is even necessary, should reward efficiency and innovation, and it should minimize administrative costs. Following these three principles will allow the Commission to continue its history of success in promoting market-based competition in special access markets.

Special access markets today do in fact exhibit extensive competition. There are many competitors; demand is concentrated;[1] and the largest buyers are themselves substantial suppliers or self providers of special access services who could build rather than lease circuits if market prices were too high. Consequently, prices are declining more rapidly than prescribed by regulation; supply and demand are increasing rapidly; and customers are increasingly putting special access services to new and different uses. For example, special access circuits are increasingly used to provide data connectivity, build out wireless networks, and supplement competitors' and incumbents' nationwide service offerings.

The Commission must not reject market outcomes in favor of regulatory prescriptions based solely on mistaken inferences from accounting data that was never intended to be used to measure rates of return on individual services. The Automated Reporting Management Information System (ARMIS) was created to provide the Commission with a generalized overview of the industry before price cap regulation, not to measure service-specific rates of return under price cap regulation. Indeed, the Commission has rejected the use of ARMIS data

[1] When USTA refers to concentrated demand, it means that the market is characterized by relatively few buyers who purchase substantial network capacity, particularly within narrow geographic areas. This concentration allows for easier entry and exit as there are lower transaction costs involved in putting together an adequate customer base to cover costs and earn an adequate return on investment.

for this purpose, and it would be a mistake for the Commission to conclude that there are problems with special access market performance based solely on such unreliable measures. In fact, ARMIS calculations also show switched access margin declines and even losses at the same time as the alleged special access margin increases. This is an improbable result, and the only natural conclusion for these two events is that ARMIS is not accurately assigning costs to the various services provided over the network, particularly after the separations freeze.

Based on these fundamental principles and clear factual evidence of competition rather than natural monopoly, USTA offers four concrete recommendations for the Commission as it acts on the NPRM:

1. continue to foster competitive investment and entry by preserving current price cap levels, rather than deterring investment and entry through re-initialization or other manipulation of current rates;
2. continue the successful transition to a free market by allowing voluntarily-negotiated commercial special access agreements everywhere, and adjusting the Phase II triggers to account for competitors that do not need collocation to offer competitive services;
3. decline to adopt a productivity factor to manage future earnings, as this is unnecessary and the inevitable mistakes will harm the public interest; and
4. decline to prejudge the outcome of this proceeding by adopting interim rules, which are absolutely unwarranted.

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The Commission has followed a policy of encouraging competition and reducing regulatory management of special access services for approximately twenty years. This policy has produced vibrantly competitive markets in which customers have many choices of providers and services offerings at steadily declining prices. Additionally, the Commission's pricing flexibility rules enable customers to secure more individualized contracts that meet their unique communications needs. Entry and exit have occurred and continue to occur freely, and technological innovations quickly reach the market through the competitive process. By any measure, the Commission's special access policy has been successful. The Commission should build on this success by further relaxing its regulation of special access, thereby making way for positive market-driven outcomes. The Commission should reject calls by those who would have the Commission turn back the clock to re-regulate this mature, competitive market.

The Commission asks many questions in the Notice of Proposed Rulemaking (NPRM)[3] about the next phase in its special access policy and rules. USTA submits that the Commission should use this phase to build on its special access successes by extending pricing flexibility so as to rely in the first instance on competition and commercial agreements to determine market

[3] *Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994 (2005).

outcomes. In particular, the Commission should allow commercially-negotiated arrangements throughout the country as they can only benefit customers given the continued existence of regulated tariffed rates that serve as the default from which voluntarily negotiations can only result in better outcomes for both parties.

There are three fundamental principles for the Commission to follow in its oversight of special access markets: (1) the Commission should encourage investment in special access networks; (2) competition in customer-driven markets produces outcomes superior to regulatory prescriptions, and market-based competition is better able than regulation to respond efficiently to rapid technological change; and (3) regulation, to the extent it is even necessary, should reward efficiency and innovation, and it should minimize administrative costs. Following these three principles will allow the Commission to continue its history of success in promoting market-based competition in special access markets.

I. USTA'S DIVERSE MEMBERSHIP PROVIDES A UNIQUE AND VALUABLE PERSPECTIVE

USTA represents a broad range of service providers and suppliers for the converged telecommunications and Internet industries. USTA members provide a full array of broadband and voice, data and video services over wireline and wireless networks. In particular, most USTA members offer many or even all of the following services: (1) wireline local residential services; (2) wireline local business services; (3) wireline wholesale services, both local and long distance; (4) wireline long distance services; (5) wireless services to both residential and business customers; (6) Internet access and data networking services in both residential and business markets; (7) diverse information services, including directory and operator services; and (8) video distribution services. Some USTA members are among the largest companies in the industry, with nationwide service territories; others are among the smallest companies,

serving just one community each. Finally, USTA members serve nearly all of the nation's demographic and geographic segments, from the densest urban block to the most sparsely populated rural plain, and from as far east as Maine to as far west as Guam.

With respect to this proceeding, USTA members include many of the largest providers of special access services, including most of the regulated suppliers, and many USTA members are substantial *purchasers* of special access services themselves or through affiliates. In fact, some USTA members are net purchasers of special access services. Because a fundamental purpose of the Commission's regulation of special access is to protect consumers and promote market efficiency, USTA hopes that the Commission finds these Comments reflecting a broad cross-section of the industry to be valuable in this proceeding.

II. FUNDAMENTAL PRINCIPLES

A. The Commission Should Encourage Entry and Investment

Commercial arrangements made in competitive, consumer-driven markets are the surest path toward innovation, efficiency, high quality services, and low prices. In turn, facilities-based competition between efficient networks is the most effective prescription for competitive markets. There is no question that special access markets are mature and competitive. Accordingly, as the Commission considers the appropriate set of market rules to guide special access markets going forward,[4] it should adopt policies and decisions that promote network investment and rely on market-driven outcomes. Decisions that continue the Commission's steady progress away from regulatory micro-management are imperative; dramatic reversals of

[4] In particular, the Commission wrote in the NPRM that it is considering the appropriate "special access regulatory regime that should follow the expiration of the CALLS plan, including whether to maintain or modify the Commission's pricing flexibility rules for special access services." NPRM ¶ 1 (citing *Access Charge Reform*, CC Docket No. 96-262, Sixth Report and Order, 15 FCC Rcd 12962 (2000) (*CALLS Order*)).

decades-old policies rewarding efficiency, however, would severely undermine the prospects for future investment.

Special access infrastructure requires substantial capital investment, so companies investing in special access facilities must be reasonably confident that they will be able to profit to the extent justified by competitive markets, and not see their returns drastically curtailed after the fact to comport with regulators' ideas about the returns they should have received. Otherwise, service providers, including both current providers and potential entrants, will not take the risk of making these critical investments.

Because of the magnitude of the investment risk at stake, the Commission's decisions in this proceeding will affect more than just those companies that have made substantial investments in the past. These decisions also will have a powerful impact on future investment as the outcome will affect investor expectations for the foreseeable future. In brief, the Commission must recognize the value of companies' networks and allow markets rather than regulatory accounting to determine the appropriate return on investments.

B. Competition-Driven Markets Are Superior to Regulatory-Created Markets

Market competition can respond to technological change and changing cost structures far more quickly and accurately than can regulatory prescriptions. To the extent that returns on investment are thought to be too high, competitive entry will respond to the perceived profit opportunities presented more quickly than could regulators. This competitive entry will either reduce returns or confirm that high returns are appropriate given investment risks. Regulators are far more likely, on the other hand, to misjudge market conditions and respond inappropriately, which would deter future investment.

Therefore, the Commission should focus it attention on the requirements for competition, and indicia that competition is working, and it should not attempt to control the outcomes that are produced by competitive markets. As the industry moves forward with increasing competition and deployment of new technologies, special access regulation should continue to diminish until special access services and the networks on which they are provided are treated the same way as other competitive markets in our free-market economy.

C. Regulation, to the Extent It Is Even Necessary, Should Reward Efficiency and Innovation, and Minimize Administrative Costs

The goal is not to manage special access returns. Rather, it is to "promote competition and reduce regulation in order to secure lower prices and higher quality services . . . and encourage the rapid deployment of new telecommunications technologies."[5] The Commission has long recognized that the best way to move from regulatory management to competitive markets is to allow providers to receive the benefits of investments in efficiency and new facilities.

The Commission concluded when it adopted price cap regulation for large local exchange carriers, that price cap regulation would serve as a transition to competitive markets by giving the carriers greater incentives to innovate and improve efficiency as they could realize greater returns from such improvements.[6] Price cap regulation also reduced administrative costs for the largest carriers as it removed the need for more burdensome tariff review and ratemaking proceedings. These are the reasons the Commission decided to move

[5] Preamble to the 1996 Act, which can be found at Committee on Energy and Commerce, United States House of Representatives, *Compilation of Selected Acts within the Jurisdiction of the Committee on Energy and Commerce*, Communications Law at 413 (April 2003).
[6] *Policy and Rules Concerning Rates for Dominant Carriers*, Second Report & Order, 5 FCC Rcd 6786 (1990) (*LEC Price Cap Order*); *Price Cap Performance Review for Local Exchange Carriers*, First Report & Order, 10 FCC Rcd 8961 (1995).

the largest ILECs to price cap regulation and to grant them pricing flexibility. Customers have benefited significantly as rates are lower, supply and demand are greater, and innovation has increased.

III. THE COMMISSION'S MARKET-BASED POLICY TOWARD SPECIAL ACCESS HAS BEEN SUCCESSFUL

The Commission's special access policy and rules have been central in its long tradition of progress toward consumer-driven markets. Over thirty years ago, the Commission began removing prescriptive regulation and creating the conditions for consumer-driven markets in terminal equipment.[7] In the years that followed, communications equipment competition grew and thrived to consumers' great benefit, and the Commission started the process of replacing regulation with competition in other communications markets, including long distance,[8] enhanced and information services,[9] commercial mobile wireless telecommunications,[10] and others. The Commission established rules creating the conditions for special access competition during the 1980s[13] and, in 1996, Congress opened local service markets to competition,[14] which further developed special access competition as high-capacity facilities could be used for local services as well as exchange access.

In many ways, it is easier to enter and compete in special access markets than in many other telecommunications markets. Demand for special access is highly concentrated,[15] as the

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[7] *E.g.*, Jonathan E. Nuechterlein & Philip J. Weiser, *Digital Crossroads* 57-59 (MIT Press 2005).
[8] *MTS & WATS Market Structure*, Memorandum Opinion & Order, 97 FCC.2d 682 (1983)
[9], Nuechterlein & Weiser, *supra*, at 151-55.
[10] *Id.*, at 270-74.
[13] *Id.*, at 64-66.
[14] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56.
[15] As explained above, *supra* note 1, by concentrated demand, USTA means that the market is characterized by relatively few buyers who purchase substantial network capacity, particularly within narrow geographic areas.

Commission has recognized many times.[16] This makes special access markets more competitive than many other telecommunications markets as competitors do not require as substantial scale and scope economies in order to compete effectively. USTA anticipates that the record in this proceeding will be filled with detailed evidence of the extent to which entrants and established providers are contesting most special access service requests. In addition, special access is typically purchased by facilities-based service providers who have the capability for building their own special access circuits (and, indeed, often do self-provide or wholesale special access circuits) should market prices be too high in relation to the costs of providing service.

In fact, the Commission removed barriers to entry and encouraged competition in the 1980s,[17] many years *before* the 1996 Act. By the time of the 1996 Act, competitive access providers (CAPs) had deployed substantial networks and won significant business in many of the larger markets in the United States.[18] Over the years, price cap regulation was modified to better encourage efficiency, in particular by ending the original price cap rules requiring carriers to share any additional profits above the authorized rate of return with customers (who were already sharing in the benefits through lower prices).[19]

After the 1996 Act, competition grew rapidly as new competitors offered local telecommunications services in addition to competitive access services over their networks,

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[16] *E.g.*, *Access Charge Reform*, CC Docket No. 96-262, Fifth Report & Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221 (1999) (*Pricing Flexibility Order*); *Access Charge Reform*, CC Docket No. 96-262, First Report & Order, 12 FCC Rcd 15982 (1997 (*Access Reform Order*).

[17] *Expanded Interconnecion with Local Telephone Company Facilities, Amendment of Part 69 Allocation of General Support Facility Costs*, Report and Order and Notice of Proposed Rulemaking, 7 FCC Rcd 7369 (1992)

[18] *E.g.*, *Access Charge Reform Order*, 12 FCC Rcd 15982.

[19] *Id.*

which facilitated entry. The explosion of Internet traffic further facilitated entry and competition as new demand gave competitors opportunities for rapid growth. The Commission facilitated the development of competitive markets by granting incumbents pricing flexibility in response to competition.[20] Consequently, market prices increasingly responded to competition rather than regulatory pricing mandates.

Every step of the Commission's highly successful progression away from strict regulatory management of market prices and outputs toward consumer-driven market competition has been resisted strongly by various parties. Nonetheless, the fears of the nay-sayers have not been realized. Instead, competition has flourished; prices have declined rapidly; supply and demand have expanded substantially; special access services have been put to many new uses; and the costs of regulation and compliance have shrunk. In sum, the Commission's progress toward market-driven competition has been successful and should be continued.

IV. SPECIAL ACCESS COMPETITION IS VIBRANT AND GROWING

A. Direct Wholesale and Retail Competition Abounds

There are many competitors in special access markets today, particularly responding to service requests from large, national accounts.[21] The record that develops through comments, reply comments, and ex parte filings in this docket will show substantial competition exists today and how routine it has become for special access customers to receive multiple offers to meet service requests. Moreover, most special access circuits are sold to purchasers that are

[20] *Pricing Flexibility Order*, 14 FCC Rcd 14221.

[21] *See, e.g.*, Letter dated October 4, 2004 from Evan T. Leo, Counsel for BellSouth Corporation, SBC Communications, Inc., Qwest Communications International, Inc., & the Verizon telephone companies, to Marlene Dortch, Secretary of the Federal Communications Commission, submitting UNE Fact Report 2004, *Unbundled Access to Network Elements*, WC Docket No. 04-313 (October 2004) (*UNE Fact Report*).

quite capable of building their own circuits, which provides a formidable check on special access prices—if prices are too high, then the customers will stop outsourcing and deploy their own facilities. In addition to actual competition evidenced by market offerings, the record in other recent proceedings shows great amounts of collocation, and other entry and investment.[22] This is not surprising because special access demand is highly concentrated in a relatively few geographical locations, allowing for greater ease of entry and exit.

Other services also constrain special access prices because of inherent substitutability with special access services. For example, switched access services historically have restrained special access prices and margins, and they will continue to do so, particularly if the Commission implements intercarrier compensation reform, which is likely to reduce switched access rates. One of the original uses of special access services—direct trunking from interexchange carriers' points of presence to large business customers and individual central offices—remains a major share of the special access market. Should switched access pricing decline substantially, special access will become less attractive for some of these customers and the resulting decline in demand will put downward pressure on special access prices. Similarly, retail broadband lines (e.g., DSL, cable modem, wireless, powerline broadband) provide additional constraints. Such services are becoming substitutable with DS-1 special access circuits as they offer comparable capacities and customers are increasingly able to use them to transmit most of the same services that are provided over DS-1s. In addition, cable companies

[22] *E.g.*, *UNE Fact Report*, *supra*.

have deployed facilities that allow them to compete in this market,[23] and wireless offerings (e.g., WiMax) are beginning to be deployed as competitive services.[24]

B. Special Access Prices and Services Are Responding to Competition and Changing Customer Preferences

Even as reported in ARMIS, special access prices measured as revenue per line have declined significantly over the past five years.[25] This is even more impressive when considered together with the fact that special access demand has increased substantially over the same time period, which generally puts upward pressure on prices. These declines have been greater than would have been mandated under the productivity factor. Moreover, competitors offer similar prices and terms, and there do not appear to be not clear distinctions between prices in markets that have multiple competitors and those with fewer competitors.

Special access prices increasingly respond to competition, actual cost of service, and customer preference, rather than being set at average prices for the whole market. For example, USTA members offer substantial volume and term discounts and, where permitted by pricing flexibility rules, they use contract tariffs to reach commercial arrangements to suit customers' individualized needs. Special access services are increasingly being purchased for uses other than the traditional use of long distance origination and termination. In particular, special access circuits are being used to build data networks and originate data as well as voice traffic. Wireless providers, which have experienced substantial growth over the past five years, are using special access services to connect their towers to their networks, which has contributed to

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[23] *E.g.*, Insight Research Corp., *Cable Telephony 2004-2009 In Small Businesses: The Competitive Threat to ILECs* (May 2004).
[24] *See, e.g.*, Towerstream Corp., http://www.towerstream.com/.
[25] *E.g.*, NPRM ¶ 20 n.77 (*citing* Declaration of Alfred E. Kahn and William E. Taylor, *AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM-10593).

the substantial growth in special access demand. Finally, competitors regularly buy circuits for resale, and this includes the ILECs, who often buy circuits from CLECs to complete service offerings, particularly as they compete in out-of-region markets or for national accounts that include off-network locations.

V. THERE IS NO RELIABLE EVIDENCE OF UNREASONABLE RATES; DON'T BE FOOLED BY THE MISUSE OF SELECTED STATISTICS

The purported evidence of high returns on special access services set forth in the NPRM does not indicate market power in the face of strong actual competition. There are many competitors and these competitors are winning sufficient market shares so that the exercise of market power is an implausible hypothesis. Instead, the single fact that ARMIS appears to show that some providers are realizing high rates of return on special access services most likely indicates that ARMIS doesn't measure returns accurately.

As the Commission recognized in the NPRM, it is questionable to rely "on accounting rate of return data to draw conclusions about market power."[27] Indeed, ARMIS was not designed to accurately measure service-specific rates of return under price cap regulation, which led the Commission to state that ARMIS should not be used for ratemaking purposes.[28] This fact alone should cause the Commission to abandon the proposal in the NPRM to reduce special access rates in response to ARMIS-generated evidence of supposedly excessive returns. There simply is no credible evidence indicating that current rates are not just and reasonable.

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[27] NPRM ¶¶ 129, 170, and n.167.
[28] *See, e.g., Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket 87-313, Order on Reconsideration, 6 FCC Rcd 2637 ¶ 194 (1991)
[30] *Jurisdictional Separations and Referral to the Federal-State Joint Board*, Report & Order, 16 FCC Rcd 11382 (2001)

Several specific problems with ARMIS data for special access services illustrate the problems with using it for ratemaking purposes, or even to estimate rates of return. First, as the Commission itself has recognized, ARMIS cost allocations are not reflective of the actual costs incurred in providing the various services.[30] The separations freeze made this problem worse, as substantial declines in switched access usage and substantial increases in special access usage have not been reflected in ARMIS cost allocations. Second, and potentially related, ARMIS shows *switched* access returns as declining across the board, and even turning negative for SBC, over the same time period.[31] While it is possible that switched access has become a money-losing proposition, it is more likely that this indicates a mismatch between accounting revenues and accounting costs that could very well be the source of overstated special access returns in ARMIS.

It should be expected that competition would cause some services to become more profitable than before, while others are becoming less profitable. Long distance deregulation produced some price and margin increases for individual services and service offerings, providing a useful example of how competition works in telecommunications markets.[32] As long distance became more competitive, basic rates often increased even as costs generally were declining, causing accounting margins to increase for individual services (particularly on-demand residential service with no volume or term commitments). Contract and promotional rates went down, however, and so did overall prices, making consumers generally better off. The same trend may be happening with special access and other access services and, just as it did not re-regulate basic long distance services in response to price increases for on-demand

[31] SBC Communications Inc., Reply Comments, *Unbundled Access to Network Elements*, WC Docket No. 04-313 (Oct. 19, 2004)

[32] *E.g. Motion of AT&T To Be Reclassified as a Non-Dominant Carrier*, 11 FCC Rcd 3271 (1995).

service, the Commission should not re-regulate access services based on possible increases in rates of return on specific service offerings.

VI. RECOMMENDATIONS

As shown above, special access markets are characterized by competition rather than natural monopoly, and the ARMIS data described in the NPRM are utterly unsuited to support a contrary hypothesis. Based on these facts and the three fundamental principles for special access regulation explained above—promote investment, rely on competition, encourage efficiency—USTA offers the Commission four concrete recommendations as it acts on the NPRM: (1) continue to foster competitive investment and entry by preserving current price caps, rather than deterring investment and entry through re-initialization or other manipulation of current rates; (2) increase pricing flexibility by allowing providers to enter into commercial arrangements everywhere to better serve customers individualized communications needs as part of the transition to a free market; (3) decline to adopt a productivity factor to manage future earnings, as the inevitable mistakes can only harm the public interest; and (4) decline to prejudge the outcome of this proceeding by adopting interim rules, which are absolutely unwarranted.

A. Foster Rather than Deter Investment, Entry, and Competition-Based Markets

As detailed above, there is no credible evidence that special access services are a natural monopoly, or even that entry is particularly difficult. In fact entry and competition are widespread, and the market is working. As a result, prices are declining and supply is increasing rapidly to meet growing demand for special access services.

In the face of such competition and market-driven market outcomes, regulatory intervention to alter market outcomes would substantially deter future investment. This would

be particularly harmful at this juncture as such an action would significantly reduce incentives for investment, particularly by creating the risk that future returns on investment may be lost at any time due to regulator action, even in the face of substantial market competition.

The Commission must not give up on the 1996 Act goals of competition and deregulation, including in special access markets. Therefore, the Commission should refuse to re-initialize special access rates, or implement any other mechanism that has similar consequences. Rate reductions through re-initialization or some other mechanism would increase investment risk in the three ways described above. Moreover, if the Commission were to adopt such rate reductions, it would amount to reneging on the compact the Commission made with the industry in the *LEC Price Cap Order* to allow providers to retain the benefits of increased efficiency until they are competed away.[33]

B. Increase Pricing Flexibility To Continue the Successful Transition to Commercial Arrangements

The public interest will be best served through the "pro-competitive, deregulatory national policy framework"[34] established in the Telecommunications Act of 1996. Accordingly, the ultimate goal for special access markets is also clear—the Commission should rely on competitive, consumer-driven markets characterized by commercial arrangements where feasible. Consumers ultimately will be the biggest beneficiaries from competitive, consumer-driven markets, as they will receive more choices and those choices will respond first and foremost to customer preferences rather than those of regulators. Further pricing flexibility will reduce disincentives for network investment, which will lead to wider deployment of better

[33] 5 FCC Rcd 6786.
[34] H.R. Rep. No. 104-458, at 1 (1996).

infrastructure and greater availability of innovative services. Reducing regulatory requirements and administrative costs will also lead to lower prices and simpler terms of service.

Commercially-negotiated agreements made voluntarily between carriers will best reflect costs, adapt to technological change, and promote competition. Accordingly, the Commission should eliminate all remaining obstacles to flexible pricing and service innovation by permitting parties to enter into commercially-negotiated agreements everywhere without regard to any indicia of competition.[35] Under this approach, current tariffed rates would remain in place and serve as a default for customers entering commercial arrangements. Where generally available tariffed offerings are available, customers will only enter commercial agreements that are more advantageous to them than the generalized tariff offerings. Accordingly, the public interest is served in extending contract pricing everywhere, and all customers will benefit by having more options for obtaining customized communications solutions. In addition, the transition to competition rather than regulation will be accelerated rather than deterred.

Secondly, the Commission must recognize that Phase II pricing flexibility is not being granted everywhere that it is called for based on market conditions. In particular, the collocation-based triggers completely miss the large and growing presence of competitors that rely on their own facilities and do not collocate. For example, there are instances where Iowa Telecom does not appear to satisfy the collocation criteria for Phase II pricing flexibility, yet competitors such as the Iowa Communications Network have won many significant contracts for special access services using their own fiber and equipment deployed at customer

[35] *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Further Notice of Proposed Rulemaking, 20 FCC Rcd 4685 (Mar. 3, 2005).

premises.[36] The market will not operate efficiently in those areas until Iowa Telecom is allowed to respond to competition using Phase II pricing flexibility. Similar problems are present throughout the country, and the Commission should take advantage of this opportunity to address this obstacle to the development of competition-based markets.

C. A Productivity Factor Is Unnecessary, and Likely Quite Harmful

The Commission should retain the ultimate CALLS X-factor, which adjusts prices for inflation, but does not impose artificial regulatory price reductions designed to mimic the increased efficiency that might be expected in competitive markets. Since the *CALLS Order*, special access prices have declined faster than they would have declined pursuant to the prior productivity offset, demonstrating conclusively that that productivity factor is unnecessary due to competition and service provider investments in efficiency. Accordingly, the Commission should let the market and competitive entry manage productivity-related price declines. This is how most markets operate, including most communications markets, and it is working well with special access markets.

Not only is a new productivity factor unnecessary but, if the Commission were to adopt one, it would send harmful signals to investors. First, it would artificially reduce potential returns on investment, potentially more so than would market competition in any given year. Such a constraint, therefore, would add to the investment risk already associated with telecommunications facilities, which inevitably would reduce investment by existing firms.

Second, a productivity factor deters investment and entry by actual and potential significant competitors. Like other investment, competitive entry depends on the possibility of

[36] *See*, Iowa Telecommunications Services, Inc. d/b/a Iowa Telecom, Petition for Reconsideration, *Unbundled Access to Network Elements*, WC Docket No. 04-313 (filed Mar. 28, 2005).

profits. In particular, competitive entrants hope to capture the benefits of superior technology or management to realize returns that cannot be matched by existing providers. If regulators mandate price reductions to mimic increased efficiency, however, competitors will realize that their potential competitive advantage will dissipate over time, even if existing providers are unable to match the entrant's technological or managerial advantages. Therefore, a productivity factor will reduce the potential gains from competitive entry and, thereby, inhibit such entry, which is directly contrary to the policy direction required by the 1996 Act.

Finally, a productivity factor will increase the likelihood of future losses. People make investments in the hope of realizing returns. While they reasonably anticipate that investments in increased efficiency will be matched over time by competitors, thereby reducing anticipated profits, they at least know that future price or revenue declines will be market driven. Such market-driven reductions will cease as the limits of increased efficiency are reached, which is basically inevitable given diminishing marginal returns. Regulator-mandated price declines based on productivity factors likely will continue even past the point at which increased efficiency is no longer possible, thereby creating the reasonable expectation of future *losses* from investment. This additional risk will only further diminish investment by current service providers and competitive entrants alike.

In sum, not only would a productivity factor fail to add to the price reductions already produced by market competition, it would also deter investment and competitive entry by sending negative signals to investors in at least three ways: (1) reducing potential returns and, therefore, anticipated average returns; (2) reducing potential gains to competitors, thereby deterring entry; and (3) creating a realistic possibility of future investment losses. The Commission should err on the side of investment, however, which means that it should decline

to adopt any productivity factor; instead the Commission should retain the current CALLS X-factor, which is equal to inflation.[37]

D. Interim Rules Are Absolutely Unwarranted--Do Not Prejudge the Outcome of This Proceeding

Interim relief is a drastic remedy as it has the effect of prejudging the outcome of a proceeding. In this case, the CALLS rules will remain in effect during the pendancy of this proceeding, so there is no pressing need for interim rules. Both the pre-CALLS productivity factor and the CALLS productivity factors, including the current X-factor (which is set to be equal to estimated inflation without any additional productivity offset) produced and are producing just and reasonable rates. Moreover, as described above, customers actually are paying less than they would be paying pursuant to a productivity factor had one remained in place. Accordingly, special access rates are presumptively just and reasonable today, and they will still be just and reasonable in July 2005, and also in December 2005 as nothing will change dramatically over the coming months.

Not only is there no need for the drastic remedy of an interim productivity factor, but the administrative and transaction costs of applying an interim productivity factor would significantly erode any benefits the Commission might attribute to productivity factor-initiated price reductions. Tariffs, discounts, billing software, sales materials, and many other operational factors would have to be modified not just once at the end of this proceeding, but also for the interim rules. Interim relief may only affect a small percentage of special access customers. Finally, at the end of the proceeding, when the Commission decides not to adopt a new productivity factor, it would need to undo the effect of interim relief, which would require special access customers to pay additional sums for services rendered and paid for. This would

[37] *CALLS Order* ¶ 163.

impose substantial transaction costs on special access customers and providers alike. Accordingly, the public interest is best served by preserving the status quo pending resolution of this proceeding.

VII. CONCLUSION

In the *CALLS Order*, the Commission noted that it would revisit its special access policy in 2005 to determine whether additional steps toward market-based competition were warranted.[38] USTA submits that additional steps toward market-based competition are indeed warranted as there is considerable competition in special access markets today. Accordingly, the Commission should continue its successful policy of promoting competition and rewarding investment and efficiency. This can best be achieved by: (1) preserving current price cap levels; (2) allowing commercially-negotiated contracts everywhere and fixing Phase II pricing flexibility relief; (3) declining to impose a productivity factor; and (4) declining to adopt interim rules.

Respectfully submitted,

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[38] *CALLS Order* ¶ 36.